RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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June 26, 1985 **LETTER 916**

June 14 DJIA 1300.96; PTI 1837; A-D Ratio -14.77
June 21 DJIA 1324.15; PTI 1846; A-D Ratio -14.46

THE MARKET: On January 12, 1906 the D-J Industrial Average closed above 100 (100.25 on that date) for the first time in history. The Dow then rose to 103.00 on January 19, moved sideways for the rest of 1906, then crashed to a low of 53.00 on November 15, 1907 (during the famous "panic of 1907").

The Dow closed above the historic 500 level on March 12, 1956 (closed at 500.24 exactly). The Dow rose to 521.05 on April 6, 1956, then fluctuated widely (but always below the April 6 mark) until July 1957. It then collapsed to a low of 419.79 on Oct. 22, 1957.

So much for ancient history. Now let's get nearer home. The Dow closed above 1000 (at 1003.16) for the first time on Nov. 14, 1972. The market continued to rise to 1051.70 in January 1973, then turned down into what was to be the worst bear market since the 1930s.

Ten years elapsed before the Dow could rise above 1100. It did that on February 24, 1983, closing that day at 1121.81. The Dow closed above 1200 (to 1209.46) two months later -- on April 26, 1983. On May 20, 1985 the Dow rallied to close for the first time above 1300 (1304.88 on May 20). All of which brings us to the present.

And the present finds us in a confirmed (by Dow Theory) primary bull market with the Dow fluctuating nervously around the 1300 level. The current situation has NYSE margins at all-time highs (a bullish indication) but with institutional cash at very low levels (a negative indication).

Technically, the recent market action has been unusual in that all the major averages have confirmed on the upside (D-J Industrials, Transports, Utilities, S&P 500, NYSE Composite, Wilshire), but some of the averages which are heavily representative of secondary issues (Amex, NASDAQ, Value Line Composite) are still lagging behind their highs of two years ago. The A-D ratio, although acting well, is still under its bull market peak of minus 12.34, recorded on June 16, 1983. Only last week (June 18) the D-J Utility Average set an all-time high of 165.37.

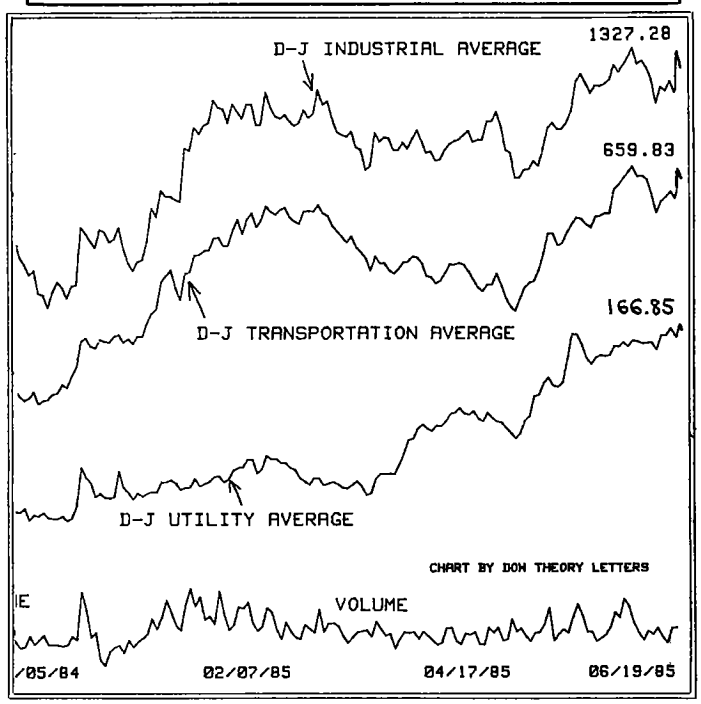
On the world picture, of 11 international stock averages that I follow, only one (Sweden) looks bearish. The 10 others (from France to Germany to Hong Kong) are correcting mildly, but so far I would say that the bull holds sway on almost all the foreign excnanges (which is a positive sign for the US, since most primary bull and bear markets tend to be international in scope).

My Primary Trend Index has served us well during the difficult first half of 1985. Even during March through May, when the Dow was declining, the PTI (see page 2 chart) continued its relentless climb. The PTI is now so far above its 89-day moving average that it would seem due for a "rest". I don't try to reason why, I simply let the PTI do its own thing, and make sure that I stay on the right side of it.

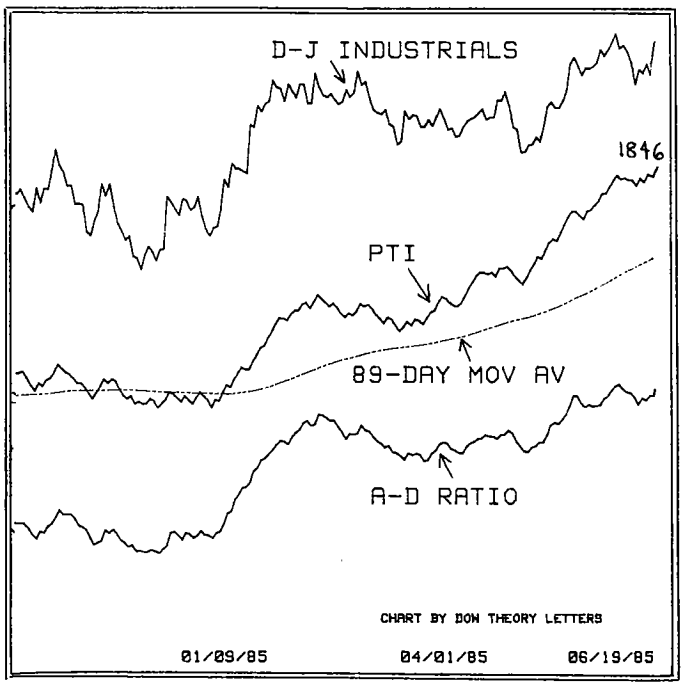
The A-D ratio (which is a proxy for ALL the stocks on the NYSE) has not been exactly a star, but as you can see (same chart) the A-D ratio has decisively bettered its February peak. So as long as the A-D is moving in direction with the Dow and as long as the A-D is bettering preceding peaks it should be graded bullish. Hopefully, before this bull market is over the A-D ratio will hurdle its 1983 high, thus clearing away one of the last technical worries in this market.

The fundamentals of the US economy are a bit exotic at this time. Consumer confidence has headed sharply down. Congressional progress on budget reduction appears slow as the Democrats (who want military cuts) and the Republicans (who want social cuts) jockey for position. As for the new tax bill, I personally can't work up any enthusiasm for it, nor it seems, can the public. The bill is hardly a step towards simplicity, and from everything I see and hear, I would say that the new tax bill (if it passes) will be very deflationary.

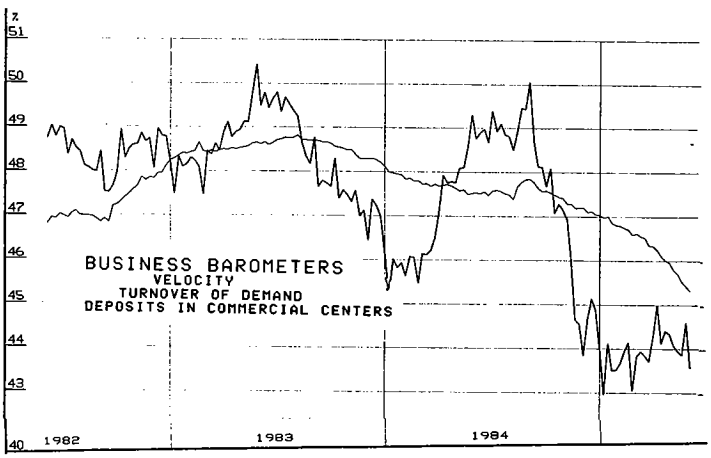
The chart of the Averages below is computer-drawn to ratio scale. All movements are therefore correctly shown in percentages (example: a rise from 200 to 400 takes up the same vertical distance as a rise from 500 to 1000).



Speaking of deflation (or inflation), the picture here is also mired in confusion. The Consumer Price Index is running at a rate of 2.4%. Commodities (and I am referring to the CRB Futures Index) are still bouncing around their lows, the computer and high-tech industries are a disaster area, the US farm industry is on its knees, and the US is now experiencing a "split economy", with service doing well and manufacturing in the tank.



All this is evidenced in the dearth of activity at the commercial bank centers. This Mansfield chart tracks velocity or the check turnover at the banks, and as you can see turnover has been sagging badly. The Fed is obviously worried sick by this, and since the first of the year, they have increased M-1 at a white-hot compounded annual rate of 10.8%.



With the money supply booming, gold (see last Letter and see page 6) is coming to life. And fears of inflation could be igniting. So in the face of a galloping money supply, the Fed continues its tenuous walk betwixt inflation and deflation. The accompanying news clips give you some idea of the problems that are arising in our schizophrenic, debt-racked, inflation-deflation split economy.

With it all, the stock market has been giving a good account of itself. In the last Letter I observed that

...d Spawn a Price War

Bonaventure Slashes Its Room Rates by Up to 23%

By BRUCE HOROVITZ, *Times Staff Writer*

The Westin Bonaventure, the largest hotel in Los Angeles, said Monday that it has slashed room rates by as much as 23% in a bid to attract new business, fueling speculation that a room-rate war could erupt among Southland luxury hotels.

The 1,474-room Bonaventure, which has seen a sharp decline in business over the last two ...

ductions are not planned for Westin Hot... 53 other locations, although ... subsidiary of ... rate c... W... the rate... soo... the its

U.S. Trade Gap Was $30 Billion In First Quarter

By ALAN MURRAY
Staff Reporter of THE WALL STREET JOURNAL

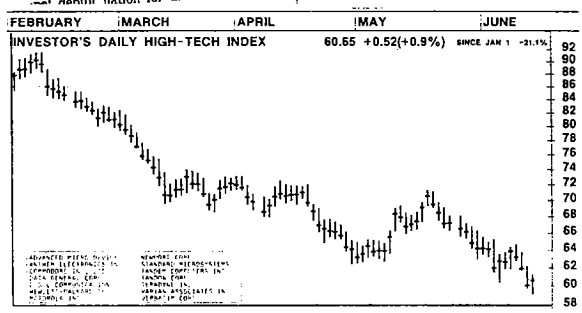
WASHINGTON – Heavy borrowing abroad to finance unprecedented trade deficits has probably turned the U.S. into a ... debtor nation for the first time since

Mexico Slashes Heavy Oil Price $1.50 a Barrel

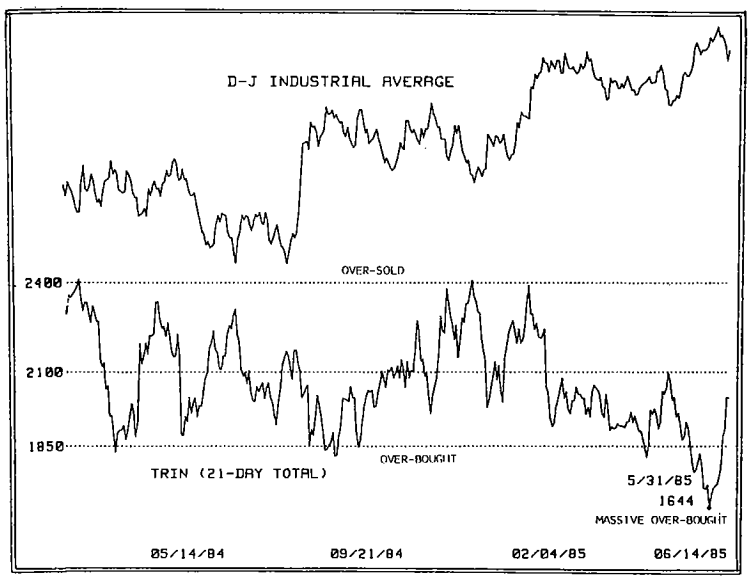
Action Follows Reports of Cuts by Britain, China

By JUAN M. VASQUEZ,
Times Staff Writer

MEXICO CITY—Mexico slashed the price of its most widely used variety of oil by $1.50 a barrel Monday, only two days ...



the "trading index" (MKDS or TRIN) was indicating a heavily over-bought situation around late-May (see accompanying chart). In fact, the May 31 figure of 1644 is the most over-bought figure I have seen on my TRIN index (21-day moving average). When a strong market is over-bought, it works off that situation while holding intact (a weak market will cave in from an over-bought area). Obviously, the current market is working off the late-May over-bought in very strong fashion. That impresses me. This market, so far, has very little give in it.

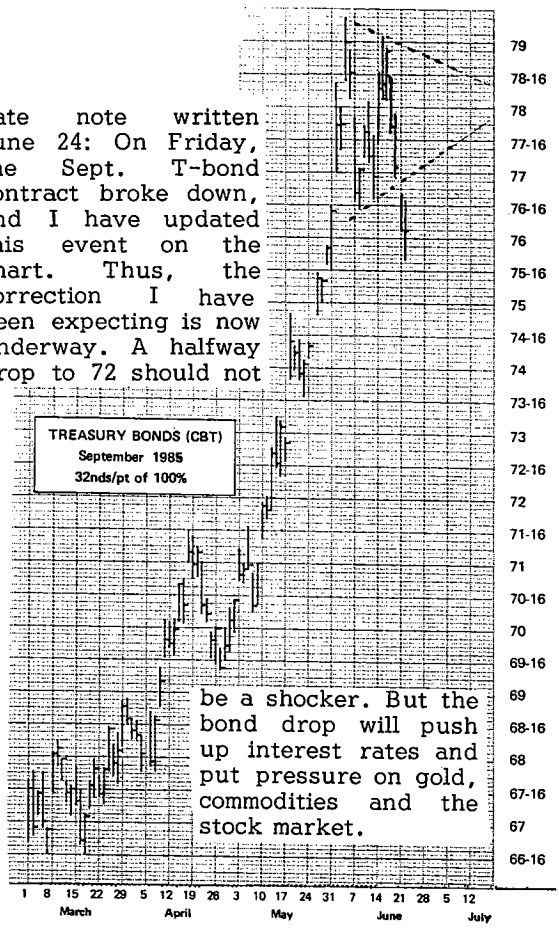


BONDS, RATES: There are those who swear that the whole 1985 rise in the stock market was based on declining interest rates (rather than being a reflection of rising corporate profits). Maybe, maybe not, but

one thing is certain: the trend of bonds (and therefore, interest rates) is critical at this juncture.

The bond rally so far in 1985 has been a beaut. The total return for long-term governments (interest plus appreciation) was about 35% over the last year. Most stock market practitioners didn't match that. But the question is -- what's next for bonds and interest rates? In the last Letter I wrote that I received my first "caution signal" in the money markets. Since then, we've had new lows (for interest rates) on the T-bills. But the T-bonds stalled. They didn't confirm the action of the bills.

As you can see on this Dunn & Hargitt chart, the T-bond futures have exploded almost perpendicularly. The bonds hit 79.12 and since then they have settled back into a consolidation/correction. For my newer readers, I should explain that bond prices are an inverse of long-term interest rates. So if the bonds correct, rates are going to rise. And the last thing the stock market or the economy wants at this time is rising rates.



Late note written June 24: On Friday, the Sept. T-bond contract broke down, and I have updated this event on the chart. Thus, the correction I have been expecting is now underway. A halfway drop to 72 should not be a shocker. But the bond drop will push up interest rates and put pressure on gold, commodities and the stock market.

Every market maven in the nation has given his projected date for the next discount rate cut. As this is written, the discount rate is still 7.5%, and Mr. Volcker doesn't like to be second-guessed. But never mind the discount, I'm more interested in the actual action of the bonds. A rise to 80 on the Sept. futures will mean an upside breakout (bullish for bonds). Below 76½ for the Sept. futures will present a very toppy-looking structure. Don't brush off this study. A major bond top here would be the financial event of 1985.

INVESTMENT POSITION: The PTI has been climbing relentlessly higher, posting record high upon record high. Now, with a record short interest in a newly reconfirmed primary bull market, the pressure is on, and that pressure is to the upside. One of the surprises (for me) is the strength of the financial section and more particularly the banks, this in view of dire warnings about international credit. The market, in a phrase, refuses to worry.

The strongest Dow stocks here (and I like them all) are Amer. Brands, Amer. Can, Amer. Express, Amer. Tel., Exxon, Gen. Foods, Merck, Owens-Illinois, United Technology, Westinghouse and Woolworth. The two bellwethers (supposedly), IBM and GM, are both showing deteriorating relative strength. Normally, a weak GM and IBM would shake the market but not so far. So the bull stays in the box. Hold off on any more bonds, and hold off on gold.

KONDRATIEFF? Many astute friends of mine in the advisory business have been saying that we are now in the downward phase of the great 54-56-year Kondratieff cycle. I can't confirm this. I've seen good articles to the effect that there is indeed a "long wave" or Kondratieff cycle. And I've known intelligent analysts who totally reject the concept.

I have my own theories and intuitions. But I do know this. When debt builds up to the point where it now is (in both the US and the world), then there's going to be trouble ahead. Any time you borrow, you're creating a DEMAND on the FUTURE. When you borrow as much as the US has (to say nothing of Latin America), then you are placing demands on the future that cannot realistically be met. At least they cannot be met with today's currency values (dollars, pesos, francs, what-have-you).

So what happens? There are four basic paths: (1) You deflate and the debt is ultimately bankrupted away. (2) You outright renege on the debt. (3) You inflate the debt away. (4) You stretch out the debts as much as possible, change the terms if necessary, and pass the whole mess on to the next generation. So far, the US and its citizens have opted for 3 and 4. But a bit of No. 1 is now appearing. In proof, I offer this clip from AP, which appeared on June 12.

Prices Fall for a Fourth Year — Largest Drop Since '33

WASHINGTON, June 11 (AP) — United States farmland plummeted 12 percent in value in the last year, a drop so steep that it delayed the release of the information as statisticians double-checked their figures, the Department of Agriculture says.

The decline was the largest one-year drop in farmland values since the Depression, and it was the fourth straight year of falling prices for agricultural acreage, the department said last week.

Reasons for the decline included farmers' credit problems, low commodity prices, high interest rates and the large number of farms flooding the land market, said Bill Heneberry, a researcher with the department.

Despite great pumping by the Fed, we see some signs of deflation in the US. Aside from the disastrous drop

in farmland values, commodities are in a bear market, precious metals are in the doldrums, real estate prices are toppy in most areas, and the prices of manufactured goods are soft. On top of that, foreign competition remains murderous, as seen for instance in the textile industry, the shoe industry, in electronics and coming up in heavy appliances (for the first time, Japan is going after the refrigerator, stove, washing and drying machine and heavy appliance market in general).

I made the statement several years ago (and I repeated it often) that I am most certain of one of my predictions. I will repeat this prediction again. In view of the mountain of debt that has been accumulated in the US, in view of the fact that we now produce $3 of debt for every $1 of increase in the GNP, I predict that the US standard of living is heading down. I am more sure of that than any other statement that I can make about our economic future.

What does that mean for you and me as investors? I believe it means that in coming years the operative word is going to be INCOME. It was with this in mind that I recommended bonds at the 1984 lows. If you want to keep your standard of living UP, you are going to need safe, sure income. That concept will gain increasing importance in the years ahead. I'm absolutely convinced of it.

Income is a function of profits. Without profits, there is no income (the one exception to this is the income produced via slavery, and this, of course, is the method that keeps Russia afloat). In the free world, Japan is the current master of profits and income. The US, once the citadel of profits, is fast becoming the loser (if you don't believe me, look at our balance-of-payments). The US, so far, has kept its standard of living up by borrowing, by shipping out dollars to foreigners who have readily accepted them. Ultimately, this process will come to a halt. The US will either produce wanted merchandise at a profit or slump into depression. I'll stake whatever reputation I have on that prediction.

NOTES & QUOTES: Technicals: The action in commodities is now so important that I want to repeat this long-term chart from Commodities Research Bureau. This is the widely-watched CRB Futures Index covering 27 commodities (including silver but not gold). On June 20, this index closed at a new three-year low of 228.8. This position takes it just 3 points above the 1982 low of 226. Technically, if 226 is shattered, the index could take a futher major fall. Furthermore, a breaking of the 1982 low would give the CRB Index a very deflationary look. More in the next Letter.

* *

The latest short position on the NYSE was announced (June 20) as up a whopping 15% to a record 253 million. In a bear market, the short position is not particularly useful because the shorts are then correctly aligned with the primary bear trend. But in a bull market, record short positions are important. During a bull market a record short position implies a huge segment that is putting its money down -- against the greatest force in the market, the primary trend.

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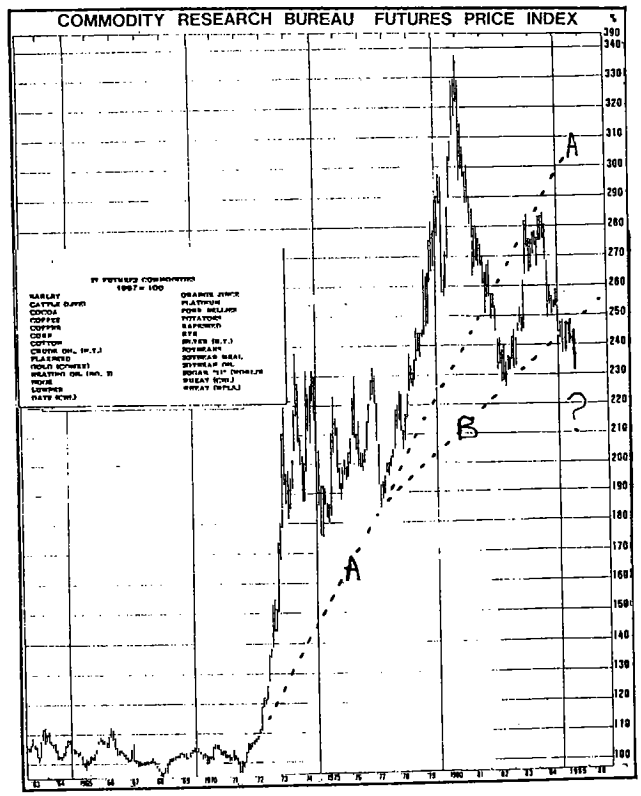

Interestingly (and probably bearish) for gold: the short position in the three big NYSE gold issues, ASA, Campbell and Homestake, dropped 26% on the latest reporting period. The short position in gold shares should build up prior to a major move in the shares and the metal.

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Tax bill? I continue to believe it's a Reagan dream (at least this tax bill). The following is from the June 21 Christian Science Monitor (which, by the way, is an excellent newspaper):

> **Three weeks after President Reagan raised the curtain on his tax-reform plan, the applause on Capitol Hill has faded. Critics are denouncing loopholes on one hand and lost deductions on the other.**
>
> **Manufacturers are sending word that the Reagan plan spells disaster for heavy industry. Losing current tax breaks for capital investments would cause many to "take a very hard look" at whether to invest outside the United States, says a spokesman for the Ford Motor Company.**
>
> **Republican members of Congress are embarrassed by the Reagan proposal to give taxpayers earning $200,000 a year the biggest cuts.**
>
> **Gov. Mario Cuomo of New York, one of the most eloquent Democratic persuaders, has launched a crusade against the provision to end state and local tax deductions for federal taxpayers.**

Reading: I read mountains of literature every week, maybe eight newspapers, dozens of magazines, books, etc. Here are some items that might interest readers. (1) The Washington Post, national weekly edition. A gem, far better than Time or Newsweek. Very liberal, but a must for anyone who has the slightest wish to understand how Washington and our government works. 1150 15th St., N.W., Wash., DC 20071. $39 a year. The Post is a great newspaper, and this is a weekly compilation of the best daily articles. (2) Grant's Interest Rate Observer, a sophisticated, highly readable newsletter aimed at the bond and money markets by ex-Barron's writer Jim Grant. I highly

recommend this informative bi-monthly. 233 B'way, NYC 10279. $250 a year. (3) Charting the Economy, Box 829, New Haven CT 06504, $95 a year. An excellent collection of charts and original ideas that may give you a different slant on the US economy. I learn a lot from this one and recommend it. Send for a sample. (4) The Economist, Britain's great weekly magazine of business, economics and almost everything else. There's more information packed in one issue of the Economist than a month of Time and Newsweek combined. I honestly don't know how they do it. PO Box 904, Farmingdale, NY 11737. $85 a year.

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Newsletters on their own

Special for USA TODAY

Financial newsletter publishers don't have to register with the Securities and Exchange Commission, the Supreme Court ruled Monday.

Because the newsletters are sold to a general audience — not geared to any one investor's portfolio — the court ruled they do not fall under the definition of "investment adviser." The ruling will affect about 600 newsletters among the 10,000 SEC-registered investment advisers.

The SEC had treated publishers as investment advisers, requiring them to obey strict advertising rules. They also had to make records of their personal securities transactions available.

"This will save me $100,000 a year in legal fees," said Brian Smith, publisher of *Personal Finance*.

Kathryn McGrath of the SEC said it will "put the burden on the consumer to ... not believe everything he sees in print."

Last week I received among other things, an offering to buy shares in a macadamia nut orchard in Hawaii. I don't know anything about growing or merchandising macadamia nuts so I tossed the offering in the wastebasket. For over a quarter of a century I've been telling my readers to do roughly the same thing. If you don't understand it, if you can't comprehend it, if it smells fishy or if it's out of your sphere of knowledge or if it sounds too good to be true, then FORGET IT. It's probably going to cost you money.

Ever since I've been in this business I've been registered with the Securities & Exchange Commission. The SEC sought to protect readers from unscrupulous, ignorant or stupid investment advisors. But to my knowledge, no one has ever successfully sued an advisory publisher and won on the basis of incorrect or stupid information issued by that advisor. In other words, "reader beware!" There's no way to avoid using your own brains.

I've never asked my readers to believe everything I write. I do the best I can, I believe I'm honest and I work my butt off -- but I can be very wrong. On June 10 the Supreme Court ruled that the SEC has no jurisdiction over advisory publishers. In other words, Dow Theory Letters is now viewed by the Court as a periodical available to the public in the same sense that Barron's is, or the Wall Street Journal. I'm no more danger to you when I recommend a stock than Barron's is (and Barron's has never been registered by the SEC). So remember, when you read Dow Theory Letters from now on, you're on your own. Of course, if you had listened to my philosophy you would realize that you've always been on your own! And that's the way it should be.

Ponzi: This is a clip from an article in the June 13 New York Times. You read something like this and it makes you wonder whether you're losing your mind. Like the old story goes, "You owe the bank a million, they own you. You owe the bank a billion, you own them!"

Argentina paid $250 million in overdue interest yesterday to its creditor banks around the world, as the United States and other governments prepared to lend Buenos Aires an additional $450 million or so.

The payment makes Argentina current on interest payments up to Dec. 30, 1984, and reduces its interest arrears to commercial banks to about $1 billion. The bridge loan by the various governments will allow Argentina to make further payments.

"The payment is another positive step by the Government of Argentina," said William R. Rhodes, a Citibank official who leads the committee of banks negotiating with Buenos Aires. He said it would help the banks

* *

What, me worry? The Comptroller of the Currency keeps a list of "problem banks". The list now shows that of the 14,700 commercial banks, 950 are on the problem list (6.4%). The Federal Savings and Loan Insurance Corp. used to keep a comparable list (list of S&Ls with a net worth of below 2%). When the number reached 265 (out of 4,000 thrifts), the FSLIC quit publishing the list! That was in 1981.

* *

Vancouver: Want to cool off in August? The ISI Seminar will do it, and it will be held in one of my favorite cities, Vancouver, queen of the Northwest. (The gaslight area of Vancouver alone is worth the trip, its' great.) Speakers at the conference (along with me) will be Harry Schultz, Ian McAvity, Dick Fabina, Nick Deak, Monty Guild and many others. Price (postmarked before July 5) for the conference is $445 a single, $595 per couple. Write to ISI, Heritage Building, 1859 Main St., Sarasota, FL 33577 (813-955-0323).

* *

Felix Rohatyn of Lazard Freres is the man who almost single-handedly put NYC back together again when its financial seams finally split in 1975. So when Felix writes a letter to the New York Times, people tend to read that letter. I know I do. Rohatyn's latest letter appeared in the Times on May 10, 1985. The letter was in the form of a warning. I include a few paragraphs of that letter here:

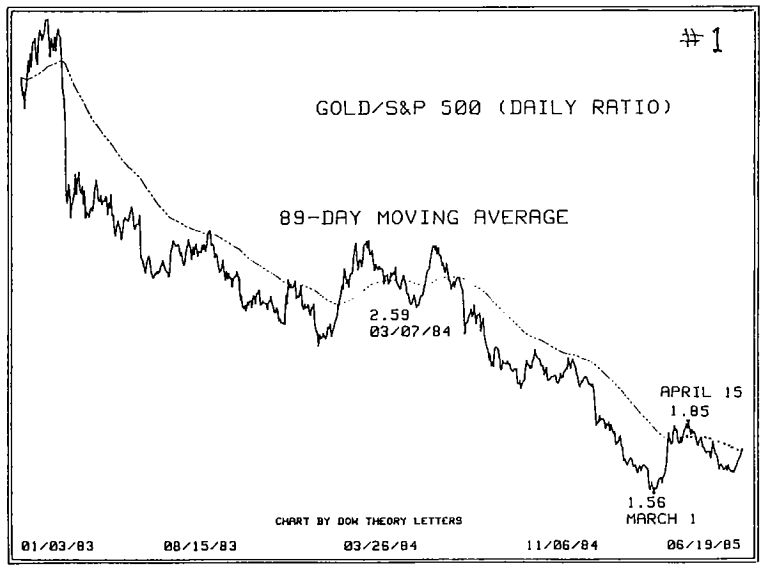
With a current deficit in excess of $200 billion, the Federal Government is today in much the same condition New York City was in 1975. The political tug-of-war between the Administration and Congress shows little promise of a serious long-term resolution of this situation. The national debt is growing at a rate that causes it to double every four or five years. Interest alone will exceed $200 billion annually and account for 20 percent of the budget in the next couple of years; it will be a growing cancer on the budget and the economy.

Similiarities to New York City in 1975 are obvious: out-of-control spending and the absence of political will for restraint. The difference is equally obvious: The Federal Government can print money and create debt, whereas the city had to rely on financial markets that, ultimately, became unavailable. But if the nation continues on its present course, there will be serious economic and financial difficulties.

Dept. of Startling Statistics: Despite years of warnings from doctors and the US Attorney General, 52% of adult Americans still smoke cigarettes! Some physicians call it a "passive form of suicide". But people still do it. ... One out of 21 US black males, or an unbelievable 4.7%, are fated to be murdered.

GOLD INFLATION: I want subscribers to study these three computer-drawn charts carefully. They can tell us a lot about gold and inflation. Chart #1 shows the ratio of gold to the D-J 20-Bonds. Since gold tends to rise during inflation and the bonds tend to decline during inflation, the direction of the gold/bond ratio provides an outstanding Wall Street forecast regarding inflation or deflation.

Here in 1985, we see the gold/bond ratio hit a double bottom, then turned up towards its 89-day moving average. We don't know yet, but that double bottom may be the market's way of telling us that the disinflationary forces are about to end.



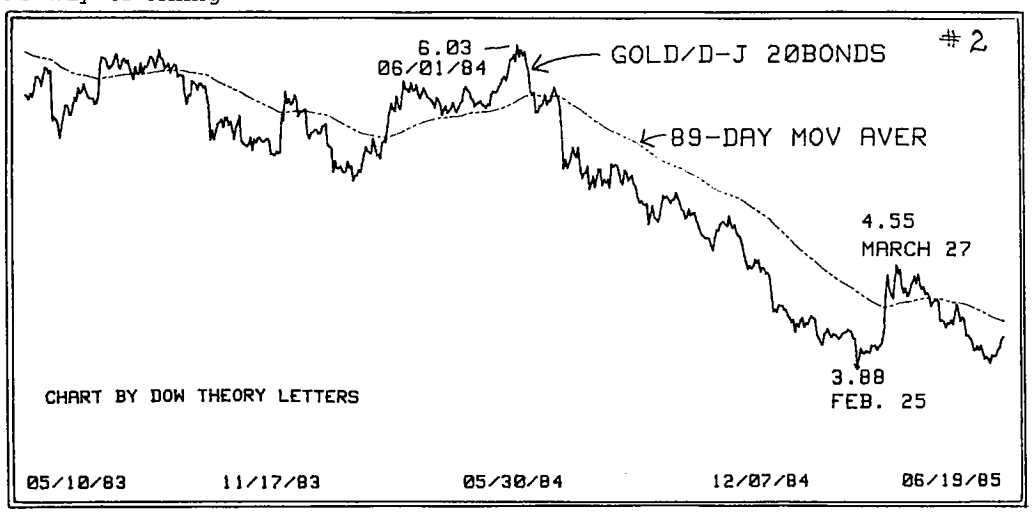
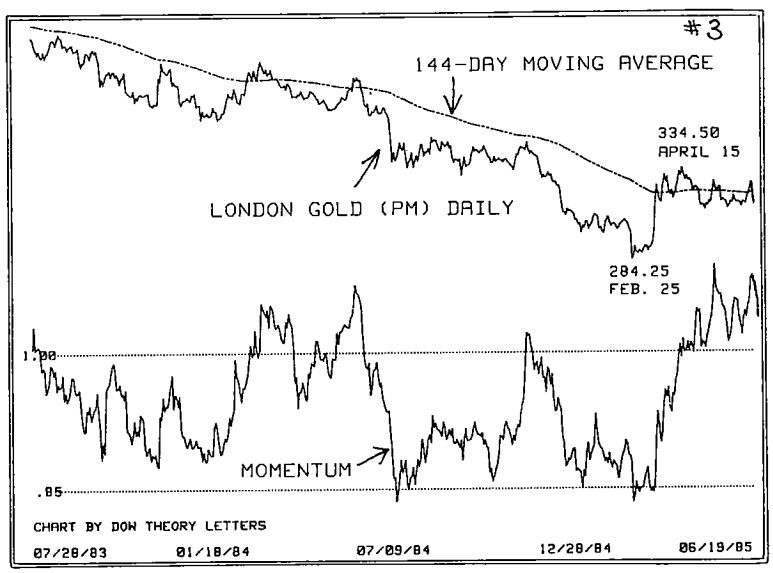


Chart # 2 shows the ratio of gold to common stocks (stocks as represented by the S&P 500 Composite). Since 1983, with the exception of one brief period during 1984, the trend of the ratio has been down or in favor of common stocks. Such a background has always been negative for gold. But early in 1985 this ratio hit a low -- and that low has held. Now the ratio is pushing above its 89-day moving average.

But that's not enough. For a real reversal, I would want this ratio to climb above its April 15 peak. If that happens, it would mean that gold was acting stronger than common stocks -- on a trend basis. When the gold-stock ratio turns up on a trend basis, the implication is that inflation is starting up, or that there is going to be trouble in the banking system. A rising ratio is also very positive for gold.

The third chart tracks gold itself. Here we see gold fighting to hold above its 144-day moving average. That moving average has given gold trouble for the past three years. Every time gold hurdles its 144-day MA, smack, it falls back again! The latest example was June 20.

The lower section of the chart shows gold momentum (89-day rate-of-change). Gold momentum has been bullish (i.e., above 1.00) for a few months, and this is the single most hopeful sign for gold-philes. But I have stressed that gold must better its April 15 peak of 334.50 in order to give a "buy signal" on my studies. So far, I cannot in good conscience recommend any buying of gold or gold shares. The critical number for gold is 334.50. Unless or until that point is bettered on a London fix, sit tight. The chart shows us the technical struggle that has been going on in the yellow metal. But so far, the bulls are still not in the saddle.



LATE NOTES: Can markets predict? Maybe not perfectly, but they're better than any economist I know of. If inflation or recession is in the American future, you don't see it in the action of the stock market or the precious metals. On June 21 (Friday), my PTI finished at an all-time high of 1846. At the same time the D-J Utility Average finished at a record high of 166.85. Conclusion: Don't fight the tape!

NEXT MAILING: July 10